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SIPDIS

SENSITIVE

DEPT PASS TO EX-IM KENNETH VRANICH AND BERT C. UBAMADU  
DEPT OF TREASURY PASS TO C. ALEXANDER SEVERENS

E.O. 12958: N/A

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SUBJECT: 2005 NIGERIAN STOCK MARKET NEGATIVELY AFFECTED BY  
BANK REFORMS

1. (SBU) Summary. The bank recapitalization process continues to weaken the Nigerian Stock Exchange (NSE) as many investors prefer to channel their money toward bank Initial Public Offerings (IPOs) rather than daily stock market activities. The average returns on investment (ROI) for the 30 largest Nigerian companies are lower for 2005 than 2004, although still higher than average returns for U.S. blue chip stocks. Nevertheless, NSE representatives remain optimistic that returns on investment will increase once the bank recapitalization process is completed. End Summary.

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Background  
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2. (U) The Nigerian Stock Exchange (NSE) has nine branches, over 120 employees and lists 285 securities with a total market capitalization of over naira 2.1 trillion (USD 16 billion). The listed securities include: 10 federal government development stocks, 57 industrial loans/bonds/preference stocks and 218 equities. Average daily trade volume on the NSE is between naira 200 and 300 million (USD 1.5 to 2.2 million). The NSE estimates five million Nigerians invest in the stock exchange.

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Secondary Markets Depressed  
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3. (SBU) Technical Advisor to the Director General of the NSE, Nicholas Okoye, told us the bank recapitalization process has hurt his institution because more people are investing in Initial Public Offerings (IPOs) by banks than making daily trading on the NSE. Numerous banks have resorted to IPOs to raise capital to meet the Central Bank of Nigeria's naira 25 billion (USD 192 million) capital requirement. Because Nigerian investors have shifted to the primary market, the returns on the secondary market have declined, the NSE representative said. Okoye told us shareholders invested naira 225 billion (USD 2 billion) in the primary market last year, but over naira 500 billion (USD 4 billion) so far this year. He expects investments in the primary market to total naira 800 billion (USD 6 billion) by December.

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10-15 Percent ROI on Nigerian Blue Chips  
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4. (SBU) Okoye is correct. Capital shifts to the primary market are partially to blame for the considerable lowering of average returns on investment in the 30 largest Nigerian companies. 2005 average ROI for the 30 largest Nigerian companies were 10-15% compared to 40-50% returns in 2004. Moreover, with inflation hovering near 15%, any real capital gains on investment were minimal. Yet, NSE representatives predict ROI on Nigerian blue chip companies will rise to 20% in the immediate post-bank recapitalization period. The CBN's bank consolidation process required mobilizing an additional naira 600 billion (USD 4.5 billion) in domestic capital for the banking sector. Once bank recapitalization is complete, NSE representatives believe the volume of trade will increase and predict the number of investors will grow from its current 5 million to 7 million by 2006.

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Optimistic Future, But Capacity Lags  
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5. (SBU) NSE representatives are bullish about stock market expansion, and are working on plans to develop a derivatives market to include: asset-backed securities, options, and exchange-traded funds. They estimate 20 to 30 million Nigerians have sufficient capital to invest in the stock market (a figure we think is high), and that the Government's Pension Reform Act will spur further investment into the stock market. Despite optimistic growth projections,

however, NSE members stated the securities sector lacked the regulatory capacity and infrastructure to keep pace with the expansion. Okoye told us the lack of capacity hurt the sector as a whole, and that more resources were needed in the training, recruitment, and restructuring of the Security and Exchange Commission (SEC), the industry's main regulatory body.

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Comment  
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16. (SBU) Comment. The phenomenal 40 to 50% average rate of return enjoyed by Nigerian investors in 2004 is not in the cards for 2005. However, financial experts generally agree the stock market will recover and ROI will increase in 2006 as more capital returns to the secondary market. Experts agree the CBN's bank recapitalization requirement in the short-term has shifted investment from the stock market; however, the long-term benefits of bank consolidation might boost investment in the stock market. When and if larger numbers of investors begin to move to the NSE, the SEC will need to strengthen its currently weak regulatory capacity by investing more in training and recruitment, and in creating an adequate legal framework to handle the increased trading volume. End Comment.

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